States

Jr., Augustus K. ... Gallery ... Institute ... WJB ... Inc.,

Petitioners,

... Viacom Inc. and ... Inc.

Respondents.

... the United States ... the Second Circuit

... MENDELL

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QUESTIONS PRESENTED

1. Whether Respondent lost his standing under 16(b) where (a) Respondent commenced his 16(b) action on behalf of the issuer months before the business restructuring in question, (b) in such restructuring, the issuer became the wholly owned subsidiary of a parent corporation, which was a shell corporation formed for the purpose of acquiring the issuer, with the issuer being the parent corporation's only asset, and (c) as a result of such restructuring, Respondent exchanged his stock in the issuer for cash and stock of the parent corporation so that Respondent has a continuing financial interest in the 16(b) action?

2. Whether Respondent's double derivative action, brought pursuant to both Rule 23.1, F.R.C.P., and Section 16(b), obviates Petitioners' objections to Respondent's standing to recover Petitioners' short-swing profits.

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No. 90659

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

v

IRA L. MENDELL, in behalf of VIACOM INC. and, alternatively, VIACOM INTERNATIONAL INC.,

Respondents.

BRIEF FOR RESPONDENT MENDELL

COUNTER-STATEMENT OF THE CASE

The original complaint, filed on January 6, 1987 (JA1[1]), was brought in behalf of Viacom International, Inc. ("International"), whose stock had been listed and traded on the New York Stock Exchange, to recover short-swing profits made in violation of 16(b) against the defendants herein (other than the nominal defendant, International) (40a, ¶ 7). As the result of a

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1. References to the Appendices to the Petition for a Writ of Certiorari are cited "a." References to the Joint Appendix are cited "JA."

business restructuring that occurred on or about June 3, 1987 ("restructuring"), International became the wholly owned subsidiary of Viacom, Inc. ("Viacom") (JA28, ¶ 4).

As a further result of the restructuring, the shareholders of International received cash and also 17% of the common and preferred stock of Viacom (JA28, ¶ 5). The common and preferred stock of Viacom are listed and traded on the American Stock Exchange (*Ibid.*).

Prior to the restructuring, Viacom was a shell corporation incorporated for the purpose of acquiring International (JA28, ¶ 6). The only significant asset of Viacom is International (Ibid.). A subsidiary of Viacom merged into International, which thereby became the wholly owned subsidiary of Viacom (JA28, ¶ 4).

As a result of the restructuring, Respondent herein is now a shareholder of Viacom (JA28, ¶ 7).

After the restructuring of June 3, 1987, Respondent filed an amended complaint in March 1988 (JA2). The amended complaint was brought in behalf of Viacom or, alternatively, as a double derivative action in behalf of International (39a; 44a).

SUMMARY OF ARGUMENT

I.

As pointed out by the Second Circuit in its opinion herein (3a), the question of standing in this case is a threshold procedural question under 16(b), as distinguished from questions of substantive liabiiity under 16(b). A 16(b) action is not a derivative action but instead is an independent statutory proceeding. The procedural strictures that obtain in a derivative action do not apply in a 16(b) action, such as the contemporaneous requirement; the immateriality of good faith or

reasonableness of business judgment respecting failure of board of directors to institute 16(b) action; inability of defendant insider to defend upon ground of lack of demand; etc. Any "security" holder of corporation—even a bondholder—may institute a 16(b) action.

Section 16(b) liability, which has been frequently described as a "crude rule of thumb", exists without proof of actual abuse of insider information, without proof of intent to profit on the basis of inside information, and thus, in short, without fault. Thus, 16(b) liability is not dependent upon harm or injury to the corporation or issuer. The corporation or issuer is simply the statutorily designated receptacle for 16(b) profits and, similarly, a 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. It follows that a broad and flexible interpretation of the 16(b) phrase "owner of any security of the issuer" — coupled with a recognition that Respondent fulfilled the express conditions of the statute that suit be "instituted" by a security owner of the issuer — is appropriate in order to implement the remedial purposes of 16(b) and prevent their frustration or evasion.

Standing under 16(b) is unimpaired in many types of corporate restructurings, such as mergers or asset purchases. In a case decided by this Court (*Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 586, ns. 9 and 10 (1978), where, after a restructuring, a second-tier subsidiary (which acquired all the assets of the original issuer) sued under 16(b) notwithstanding the continued existence of the original issuer and the standing of the second-tier subsidiary to do so was not questioned by anyone, including this Court. If in this case Viacom acquired International by merger of International into Viacom or purchased International's assets, any security holder

of Viacom (including an after-acquired security holder) could sue upon the 16(b) claim in this case. That International became Viacom's wholly owned subsidiary instead of merging into Viacom or instead of Viacom purchasing International's assets is mere happenstance insofar as 16(b) considerations are concerned.

For years it had been the law in the Second Circuit as the result of a leading district court decision (*Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966)) that where, as here, the original issuer continues to exist without, however, any public security holders, both the subsidiary (into which the issuer had been merged) and the parent became the "issuer" within the meaning of 16(b) so that an after-acquired stockholder of the parent had standing to sue under 16(b). In more recent years, decisions of the Seventh Circuit (2-1 decision) and the Ninth Circuit distinguished the analysis in *Blau*. Thereafter, the Second Circuit held against standing because, unlike *Blau*, which was distinguished, the issuer had never been merged out of existence. Then came the instant decision of the Second Circuit in this case.

The Second Circuit's decision in this case appropriately distinguished those cases holding against standing under 16(b) in corporate restructurings, including the penultimate Second Circuit decision, upon which the author of the opinion in this case sat as a member of the panel, because of the "novel situation" and "unique circumstances" of this case (16a; 17a). Here, the restructuring in question occurred during the pendency of Respondent's properly brought 16(b) action and the former shareholders of the issuer received in the restructuring stock of the parent (a shell corporation formed to acquire the issuer which became the parent's only asset) so that the former shareholders of the issuer, including Respondent, have a continuing financial interest in maintaining a 16(b) suit in behalf of the issuer. The fact that the restructuring occurred during the pendency of Respondent's 16(b) action presented the possible danger of an intentional restructuring such as would defeat 16(b). The Second Circuit further appropriately stated in its decision in this case that the threshold procedural question of standing under 16(b), as distinguished from questions of substantive liability under 16(b), should be "determined by whether the policy behind the statute is best served by allowing the claim" (12a) and that the broad meaning of the statutory language ("owner" of securities, which language is not modified by any limiting expression) "better accords with the remedial purpose of the statute." (15a).

The Second Circuit's decision sustaining Respondent's standing under 16(b) in this case is entirely correct. This Court itself has stated that the inevitable incompleteness of all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts. Far from doing violence to the statute, reading Section 16(b) to encompass Respondent's standing in the case fulfills the purpose of the provision to deter the abuse of insider information. Further, as discussed, the unique facts of this case are particularly compelling in favor of Respondent's standing.

Moreover, the separate corporate entities of International and Viacom should be disregarded in this case for the purposes of 16(b). As noted, Viacom is a shell corporation formed for the purpose of holding International (the original issuer), which is Viacom's only asset. International is thus clearly Viacom's instrumentality or alter ego. For the purposes of 16(b) in this case, Viacom should be considered to be the owner of International's 16(b) claim against petitioners. This Court has held that corporate form may be disregarded where, as here, it

produces an inequitable result, such as the defeat of a statute or public policy, even to extent of imposing liability upon the shareholders and even though the corporation was organized in good faith and was not a sham.

II.

It is established law that a double derivative action may be brought pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. In Respondent's double derivative action in this case, Respondent is enforcing, through the accepted and established procedure of the double derivative action, the right of Viacom as a shareholder of International to sue on behalf of International under 16(b). No special reason exists against the maintainability of a double derivative action in the context of 16(b).

ARGUMENT

POINT I

THE CORPORATE RESTRUCTURING IN THIS CASE DID NOT DIVEST RESPONDENT OF STANDING TO SUE UNDER 16(b)

A. A 16(b) Action Is A Broadly Remedial Statutory Proceeding In Contrast To The Restrictive Nature Of An Ordinary Derivative Suit

While a 16(b) action has some of the attributes of a derivative suit (a stockholder can sue and the recovery inures to the corporation), it is not derivative but instead is an independent statutory proceeding. *Dottenheim v. Murchison*, 227 F.2d 737 (5th Cir. 1956) (requirement of Rule 23 [now 23.1], F.R.C.P., that derivative complaint allege that stockholder was such at time of transaction complained of inapplicable to 16(b) action).

In *Dottenheim*, the Fifth Circuit stated (Id., 738):

> "The rules of law applicable to this case are neither complicated nor unusual. The statute here involved [Section 16(b)] creates a new cause of action, which, while similar in some respects to a secondary or derivative right, is not such a right at all. It is in reality a primary right. This is so because the statute which creates it makes it so."

To the same effect are *FDIC v. American Bank Trust Shares, Inc.*, 558 F.2d 711, 716 (4th Cir. 1977); *Blau v. Oppenheim*, 250 F. Supp. 881, 885 (S.D.N.Y. 1966).

As pointed out by the Second Circuit in its opinion herein (3a), the question of standing in this case is a threshold procedural question under 16(b), as distinguished from questions of substantive liability under 16(b). A long and unbroken line of decisions liberalizes procedural requirements in 16(b) cases. As stated by Judge Irving Kaufman in *Epstein v. Shindler*, 26 F.R.D. 176, 178 (S.D.N.Y. 1960), in disallowing a counterclaim against the issuer in a 16(b) action: "'it is plain ... that it [16(b)] was primarily intended as an instrument of a statutory policy of which the general public is the ultimate beneficiary. Congress did not intend procedural restrictions to hamper such policy.'", quoting from *Benisch v. Cameron*, 81 F. Supp. 882, 884 (S.D.N.Y. 1948).

See, also, *Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir. 1954), *cert. denied*, 347 U.S. 1016 (holding, as does *Dottenheim*, that after-acquired shareholder may sue under 16(b) and requirements of Rule 23 [now 23.1] in a derivative action that the complaint allege that "the plaintiff was a shareholder ... at the time of the transaction of which he complains" is inapplicable in 16(b) action); *Magida v. Continental Can Co.*, 231 F.2d 843, 847-848 (2d Cir. 1956), *cert. denied*, 351 U.S. 972 (1956) (fact that there may be champertous relationship be-

tween plaintiff and his attorney is not a defense to a 16(b) action); *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984, 988 (2d Cir. 1947), *cert. denied*, 332 U.S. 761 (1947) (if issuer does sue under 16(b), intervention is freely granted to a shareholder "to guard against even the appearance of any concerted action"); *Pellegrino v. Nesbit*, 203 F.2d 463, 467 (9th Cir. 1953) ("any stockholder has a right to institute 16(b) suit if the corporation fails to do so, regardless of the good faith or reasonable business judgment of the board of directors."); *Prager v. Sylvestri*, 449 F. Supp. 425, 429 (S.D.N.Y. 1978) (demand requirement of 16(b) exists only for benefit of the issuer, so that the defendant insider does not have standing to assert lack of demand as a defense).

Unlike an ordinary derivative suit, any security holder of the corporation—even a bondholder—may prosecute a 16(b) action. Section 16(b) specifically provides that a 16(b) action may be maintained "by the owner of *any security* of the issuer" (emphasis supplied). The Exchange Act, in Section 3(a)(10), 78c(a)(10), defines "security" to include a "note ... bond [or], debenture". See, also, 2 Loss, *Securities Regulation* 1046 (2d ed. 1961) ("[i]t makes no difference [under 16(b)] whether the plaintiff's security is a stock or bond, registered or unregistered.").

B. The Corporation Or Issuer Is Simply The Statutorily Designated Receptacle For 16(b) Profits Irrespective Of Any Harm Or Injury To The Corporation Or Issuer

Section 16(b) liability has been frequently described as a "crude rule of thumb". E.g., *Foremost McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 251, n.26 (1976). Section 16(b) applies objectively so that it imposes liability without proof of actual abuse of insider information, without proof of

intent to profit on the basis of such information, and thus, in short, without fault. *Foremost*, *supra*, at p. 251.

It follows that 16(b) liability is not dependent upon harm or injury to the corporation or issuer. Thus, "any 16(b) award to the corporation is essentially a windfall, since the corporation has suffered no harm for which it is being recompensed." *Blau v. Rayette-Faberg, Inc.*, 389 F.2d 469, 474 (2d Cir. 1968).

The corporation ("issuer") is simply the statutorily designated receptacle for the 16(b) profits. "The statute [16(b)] channels the insider profits back into the corporation, not to an informant or person directly suffering a loss." *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). The corporation or issuer may be an "instrument [which is] sometimes unwilling, for the effectuation of the statutory policy." *Magida v. Continental Can Co.*, *supra* 231 F.2d at pp. 846-847. Hence, "the language and purpose of the statute preclude an estoppel based upon instigation by or benefit to the corporation whose shares are traded." *Ibid.*

Similarly, a 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. *Magida*, *supra* 231 F.2d, at pp. 846-47.

It follows that a broad and flexible interpretation of the 16(b) phrase "owner of any security of the issuer" — coupled with a recognition that Respondent fulfilled the express condition of the statute that suit be "instituted" by a security owner of the issuer — is appropriate in order to implement the remedial purposes of 16(b) and prevent their frustration or evasion.

C. Standing Under 16(b) Is Unimpaired In Many Types Of Corporate Restructurings (Such As Mergers Or Asset Purchases)

In *Western Auto Supply Co. v. Gamble Skogma, Inc.*, 348 F.2d 736, 739-41 (8th Cir. 1956), *cert. denied*, 382 U.S. 987

(1966), the original issuer merged, in a stock for stock exchange, into a second corporation which then transferred all its assets to a third corporation. It was held that both the second and third corporations could sue under 16(b) respecting a short-swing transaction in the original issuer's stock.

In affirming the district court upon the question of standing, the Eighth Circuit stated (*Id.* at 739):

> "In answering this proposition [of standing] affirmatively, the District Court relied principally upon the merger statute of Missouri, the State where the issuing corporation was incorporated. This statute simply operates to transfer to the successor corporation without further act or deed all rights, privileges, interests, property and liabilities, including choses in action which formerly belonged or were chargeable to the merged corporation. See Mo.Rev.Stat 351.450, V.A.M.S. (1959). The District Court also reasoned that since the legislative purpose of 16(b) was intended to protect property rights of the investing public as well as those of the issuing corporation, 16(b) must be broadly construed in reaching the decision that the chose in action here survived and was properly assigned." (footnote omitted)

Western Auto thus holds that the surviving corporation in a merger has standing under 16(b) and that the third corporation (to which the surviving corporation transferred all its assets) also had standing, notwithstanding the continued existence of the surviving corporation.

In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 586, ns. 9 and 10 (1978), the original issuer transferred all its assets, property and goodwill to a second-tier subsidiary of the first tier subsidiary of a public parent in

return for stock of the parent. The second-tier subsidiary sued under 16(b), and its standing to do so was not questioned by anyone, including this Court, notwithstanding the continued existence of the original issuer.

See, similarly, *Newmark v. RKO General, Inc.*, 425 F.2d 348, 352, n.4 (2d Cir. 1970) *cert. denied*, 400 U.S. 854 (1970), (surviving corporation in merger became owner of 16(b) claim and, further, security holder of surviving corporation, who never had been security holder of original issuer, had standing to sue under 16(b)); *Morales v. Lukens, Inc.*, 593 F. Supp 1209, 1211, n.4 (S.D.N.Y. 1984) (same, except that merger involved cash for stock).

Thus, if in this case Viacom acquired International by merger of International into Viacom or purchased International's assets, any security holder of Viacom (including an after-acquired security holder) could sue upon the within 16(b) claim. Petitioners contend that a contrary result obtains here because of the happenstance, insofar as 16(b) considerations are concerned, that International became Viacom's wholly owned subsidiary instead of merging into Viacom or instead of Viacom purchasing International's assets.

D. The Decisional Law Concerning The Effect Of Corporate Restructurings Upon Standing Under 16(b) Where, As Here, The Issuer/Subsidiary Continues To Exist Without, However, Any Public Security Holders

Blau v. Oppenheim, 250 F. Supp 881 (S.D.N.Y. 1966) was, for years, a leading case upon the law of standing under 16(b) in a corporate restructuring.

In *Blau* the initial issuer transferred all its "assets and choses in action" and also all its liabilities to the subsidiary of a public corporation whereupon the initial issuer was merged into the

subsidiary and ceased to exist (*Id.*, at p. 883). Subsequently, the plaintiff in *Blau* purchased stock in the parent public corporation and then sued under Section 16(b) to recover short-swing profits in the stock of the initial issuer (*Ibid.*).

Plaintiff and the Securities and Exchange Commission, appearing as *amicus*, argued that the statutory term "issuer" included both the parent public corporation and the parent's subsidiary which continued to exist (*Id.*, at p. 884).

The defendant argued that "since M&T [the surviving subsidiary] possessed the 16(b) right of action only as an assignee and not as an issuer, plaintiff's standing as a stockholder of American [the public parent] is necessarily derivative—in fact, double derivative—requiring compliance with Rule 23(b)." (*Id.*, at 886).

The district court in Blau rejected defendant's arguments and denied a motion by defendant to dismiss, stating (*Id.*, at pp. 886-87);

> "The court finds none of these arguments persuasive. There is no support for the defendant's position that Congress intended that suits for the recovery of short-swing profits be restricted to the initial issuer whose securities were the subject of the illicit gains and its securities holders, thus leaving no remedy in those instances where, as here, the issuer by a transfer of all its assets to another corporation has become extinct and is without its original security holders. It is true, as defendant states, that the section makes no reference to survivor or successor corporations of an issuer - but neither does it contain any bar against the maintenance of 16(b) suits by such corporations or their security owners. To deny them the right to maintain suit would serve to defeat the purpose of the law; to accord them

> the right serves to further it. The defendant's position, if accepted, would substantially cut down the availability of Section 16(b) as a remedy to security holders. Thus, under the defendant's concept, the right of security holders of an issuer to institute suit under Section 16(b) would be terminated whenever the issuer was merged with or succeeded by another corporation; the very act of dissolution of the issuer and the failure to bring suit by the date thereof would end the right of security holders to pursue the insider and have him disgorge his profits. This hardly conforms to the essential legislative policy of Section 16(b).
>
> "The defendant somewhat grudgingly concedes that his position, if upheld, would, as the SEC points out, enable unscrupulous insiders to arrange a merger or its equivalent to thwart the recovery of short-swing profits under Section 16(b). ..."

In *Blau*, as here, the subsidiary into which the original issuer had merged continued to exist and thus, as here, could sue under 16(b). *Blau* cited (Id., at p. 886, n.26) the analogous decision of the Eight Circuit in *Western Auto*, where, as noted, the original issuer merged into a second corporation which then transferred all its assets to a third corporation (the second corporation's parent) and the Eighth Circuit held that both the second and third corporations could sue under 16(b).

Blau represented the law upon the question of standing in corporate restructurings for many years and was cited approvingly by the Second Circuit. *Feder v. Martin Marietta Corporation*, 406 F.2d 260, 262 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970) and *Newmark v. RKO General, Inc.*, *supra*, 425 F.2d at p. 352, n. 4.

As pointed out, *Kern County Land, supra*, was also a case where, after a restructuring, a second-tier subsidiary sued under 16(b) notwithstanding the continued existence of the original issuer and the standing of the second-tier subsidiary to do so was not questioned by anyone, including this Court.

Then came the decisions in *Portnoy v. Kawecki Berylco Industries, Inc.*, 607 F.2d 765 (7th Cir. 1979) (2-1 decision) and *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) both of which distinguished *Blau*.

In *Portnoy*, the initial issuer (KBI), whose shareholders were cashed out, became the subsidiary (second tier subsidiary) of the first tier subsidiary of a public corporation (Cabot). A shareholder of the public grandparent (Cabot) sued under 16(b) to recover for short-swing profits in the stock of the initial issuer.

The majority in *Portnoy*, in holding that plaintiff did not have standing under 16(b), distinguished Blau upon the ground that in Portnoy the initial issuer still existed (Id., at pp. 768-9), and further stated that in any event "*Blau* went too far in granting standing to the plaintiff." (*Id.*, at p. 771).

The dissenting Judge in Portnoy stated (*Id.*, at p. 771):

> "Citing section 2(11) of the Securities Act of 1933 as an example, the majority says: 'Although the plaintiff's contention is not absurd on policy grounds, we cannot rewrite the statute to accommodate this situation. Congress has spoken clearly. When it wanted a broader definition of issuer, it drafted one.' But we need not rewrite the statute. Common sense tells us that by construction Cabot has become the issuer of the KBI stock within the definition of the statute. Put another way, KBI's identity for purposes of section 16(b) has been retained in Cabot. We should not expect Congress to

> divine-and provide for-all the possible corporate restructuring that, whether intentionally or not, can defeat the salutary purposes of the statute. The task of accommodating a statute to a given set of facts is for the courts. By such accommodation the purposes of section 16(b) can be satisfied and the laments of the majority for not being able to reach the result it seemingly longs for could be avoided."

In *Lewis*, the initial issuer, whose shareholders were cashed out, ceased to exist upon its merger into the subsidiary of a parent corporation. The Ninth Circuit held that the subsidiary succeeded to the initial issuer's 16(b) action (*Id.*, at p. 803) and assumed, *arguendo*, that the parent corporation had standing to sue under 16(b) as a shareholder of the subsidiary. The Ninth Circuit further held that plaintiff, a shareholder of the parent corporation, did not have standing to sue under 16(b) because the parent was not an "issuer" within the meaning of 16(b), stating that "[w]e decline" to follow the *Blau* analysis here." (*Id.*, at p. 804).

Thereafter, the Second Circuit decided *Untermeyer v. Valhi, Inc.*, 665 F.Supp. 297 (S.D.N.Y. 1987), summarily affirmed, 841 F.2d 1117 (2d Cir. 1988), and affirmed again in a *per curiam* opinion on rehearing, 841 F.2d 25 (2d Cir. 1988), *cert. denied*, 488 U.S. 868 (1988), which held against standing under 16(b) but which explicitly stated that it was not deciding contrary to the landmark decision in *Blau*.

In *Untermeyer*, the shareholders of the initial issuer (Sea-Land), a public corporation, were cashed out by another public corporation (CSX) and Sea-Land became the wholly owned subsidiary of CSX. Both Sea-Land and CSX had been totally separate and independent companies and the common stock of both Sea-Land and CSX had been listed and separately traded

on the New York Stock Exchange. Plaintiff, a shareholder of CSX, sued under 16(b) to recover short-swing profits that defendants therein had made in the stock of Sea-Land in violation of 16(b).

In *Untermeyer*, the Second Circuit sought to distinguish *Blau*, stating: "In *Blau*, the issuer had been merged out of existence ... Thus, unless the issuer's successor corporation or its parent was allowed to bring a section 16(b) action the short-swing profits illegally gained would never have been recovered....In contrast, the issuer here, Sea-Land, survived the merger and remains a viable corporate entity...Because Sea-Land remains a viable corporate entity, it or its shareholder, CSX, can bring an action under section 16(b) to recover the short-swing profits allegedly gained." (841 F.2d 25).

However, as pointed out by the Second Circuit in this case (13a), in *Blau*, there was a wholly owned subsidiary that was the successor of the issuer and both the subsidiary (the counterpart of Sea-Land in *Untermeyer*) and its parent (the counterpart of CSX in *Untermeyer*) could sue under 16(b).

Then came the instant decision of the Second Circuit in *Mendell* which is now before the Court upon grant of certiorari. Judge Cardamone authored the Second Circuit's opinion in *Mendell* and was also a member of the panel that decided *Untermeyer*.

E. The Second Circuit's Decision In This Case

The Second Circuit explicitly referred in its opinion herein to the "novel situation" and "unique circumstances" of this case (16a; 17a). Here, the restructuring in question occurred during the pendency of a properly brought 16(b) action and the former shareholders of the issuer received in the restructuring stock of the parent (a shell corporation formed to acquire the issuer

which became the parent's only asset) so that the former shareholders of the issuer, including Respondent, have a continuing financial interest in maintaining a 16(b) suit in behalf of the issuer.

The Second Circuit in its opinion herein distinguished *Portnoy* and *Lewis* as follows (16a-17a):

> "Contrary decisions of our sister circuits are similarly distinguishable. See *Lewis*, 762 F.2d at 801 (plaintiff shareholder of parent but never held stock in the issuer or its surviving subsidiary); *Portnoy*, 607 F.2d at 767-68 (cashout merger left plaintiff with no continuing financial interest in the litigation; plaintiff's alternative status as a shareholder in the grandparent corporation gave no standing for 16(b) suit on behalf of the issuer). In the case at bar, the conversion of International stock into Viacom stock presents a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer. We conclude, therefore, that under those unique circumstances the cases cited by defendants are neither controlling nor persuasive."

The opinion herein also distinguished *Untermeyer*, as follows (15a-16a):

> "[*Untermeyer*]...dealt with a plaintiff who owned stock of the parent corporation, but who never owned stock of the company that issued the shares traded in contravention of §16(b). 665 F. Supp. at 298. Thus, even without a merger, the *Untermeyer* plaintiff would not have had standing. In contrast, plaintiff here brought a valid §16(b) suit while he was a current shareholder of the issuer, and *but for* the merger standing would not be in issue here." (emphasis in original)

The Second Circuit in its opinion herein further distinguished its decision in *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977), *aff'd mem.* 573 F.2d 1295 (2d Cir. 1977) (16a):

> "In *Rothenberg v. United Brands Co.*, also cited by the district court, the shareholders received cash in the merger instead of securities. The crucial factor considered by the trial court was that in a cashout merger the former shareholders maintain no continuing financial interest in the litigation. See Rothenberg, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,692. In the present case all former International shareholders obtained, as a result of the merger, shares of International's parent corporation, and plaintiff, as one of them, continues to have at least an indirect financial interest in the outcome of this lawsuit. Two additional reasons caution against an overbroad application of *Rothenberg*: That decision noted that even if plaintiff had standing the 16(b) claim failed on the merits, *see id.* at 91,693-94; and the court's standing analysis was premised on an analogous application of Rule 23.1 which, as noted above, does not govern shareholders bringing §16(b) claims. Id. at 91,691-92."

The Second Circuit held, upon the unique facts of this case, that the threshold procedural question of standing under 16(b), as distinguished from questions of substantive liability under 16(b), should be "determined by whether the policy behind the statute is best served by allowing the claim" (12a) and that the broad meaning of the statutory language ("owner" of securities, which language is not modified by any limiting expression) "better accords with the remedial purpose of the statute." (15a).

The Second Circuit further stated: "A §16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy."(11a) In this regard, the Second Circuit also stated: "we cannot help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's §16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present." (17a).

It is the *form*, not the fact, of Viacom's acquisition of International that creates the standing problem here and the form of the acquisition was arranged after commencement of this 16(b) action. As pointed out, if Viacom had acquired International by merger or had purchased International's assets, no problem respecting standing would have arisen. It is a matter of public record that Petitioners sold a large block (8.4%) of International's stock to National Amusements, Inc. (which then formed Viacom to acquire International (JA31)) while National Amusements was on the verge of embarking on a contest to acquire International (JA 20-21; see also Schedule 13D Amendment No. 1, dated October 7, 1986, filed by Petitioners with SEC). Petitioners thus assisted National Amusements/Viacom to acquire International, a fact which would tend to ingratiate Petitioners with National Amusement/Viacom.

It is unrealistice to suppose that a subsidiary of National Amusements (which held Petitioners' proxy to vote Petitioners' International stock (Petitioners' Schedule 13D, *Ibid.*)) — either Viacom or International — would then turn around and sue Petitioners for disgorgement of monies that National Amusements had just paid. In that setting, absent the viability of a suit by public shareholders such as Mendell, there

would be no enforcement of Section §16(b), contrary to Congress's purpose in enacting the provision.

F. The Second Circuit's Decision Sustaining Respondent's Standing Under 16(b) Is Entirely Correct, Particularly In View Of The Unique And Compelling Facts Of This Case

As the Eighth Circuit stated in *Western Auto* in upholding standing under 16(b); "since the legislative purpose of §16(b) was intended to protect property rights of the investing public as well as those of the issuing corporation, 16(b) must be broadly construed" respecting the question of standing in corporate restructurings (348 F.2d at 739).

As further observed by the dissenting Judge in *Portnoy*: "We should not expect Congress to divine—and provide for—all the possible corporate restructuring that, whether intentionally or not, can defeat the salutary purposes of the statute [16(b)]. The task of accommodating a statute to a given set of facts is for the courts." (*Id.*, at p. 771).

This Court has similarly stated that "the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts." *United States v. Little Lake Misere Land Company, Inc.*, 412 U.S. 580, 593 (1973).

The long history of 16(b) dictates, we respectfully submit, that the Court ask itself whether the Congress that took such pains to guard against the issuer's being unwilling to sue one of its directors or officers—which is to say, by permitting *any* security holder of *any* kind to sue on the issuer's behalf—would have foregone the case of the initial issuer's having become a wholly owned subsidiary of another corporation in which plaintiff is a stockholder. The answer is clearly no.

Professor Blumberg states in his work, *The Law of Corporate Groups—Procedural Law*, p.363 (1983 ed.):

> "The controversy on the availability of the primary action centers on the weight to be given the literal provisions of section 16(b), which refer to an 'owner of any security of the issuer' and thereby literally exclude shareholders of the parent or grandparent of the issuer. In the complex corporate group, the interposition of an elaborate corporate structure, with tiers of companies between the corporate component in question and the public shareholder, would in many cases effectively disenfranchise public shareholders from instituting primary causes of action under section 16(b) with respect to constituent components. This is manifestly undesirable and a frustration of the purposes of the Act. An enterprise reading of section 16(b) seems clearly preferable to the literal construction adopted by *Portnoy*."

The unique facts of this case are particularly compelling in favor of standing. Respondent in this case owned 1,200 shares of International's common stock prior to the merger and he received in the merger not only cash but also the common and preferred stock of Viacom (a shell corporation formed for the purpose of holding International, its only asset) so that Respondent has a continuing financial interest in maintaining a 16(b) action in behalf of the issuer. Further, Respondent's 16(b) suit had been commenced prior, to and was pending at the time of, the corporate restructuring or merger, thereby presenting the possible danger of an intentional restructuring such as would defeat 16(b).

The SEC submitted an *amicus* brief below that supported the standing of Respondent Mendell under 16(b) in this case. The

decision of the Second Circuit herein thus has the support of the SEC. The Acting Solicitor General, on behalf of the SEC, is also appearing before the Court to support the Second Circuit's decision.

In a recent rulemaking, the SEC comprehensively revised its rules under Section 16. In a rule proposal and later reproposal, the SEC considered defining the term "owner of any security of the issuer" in Section 16(b) to encompass shareholders divested of their shares by a merger — as was Respondent Mendell[2] . In promulgating final rules, the SEC reaffirmed its view that a shareholder who is divested of shares as a result of a business combination transaction does not lose his Section 16(b) course of action, but, in light of the Court's grant of certiorari in this case, it determined not to adopt a proposed definition that would address the issue at this time[3].

G. Moreover, The Separate Corporate Entities Of International And Viacom Should Be Disregarded In This Case For The Purposes of 16(b)

As just noted, Viacom is a shell corporation formed for the purpose of holding International (the original issuer), which is Viacom's only asset. International is thus clearly Viacom's instrumentality or alter ego. This Court has held that corporate

2. See *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 263333 (Dec. 2, 1988, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 84, 343, at 89, 620; *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 27148 (Aug. 18, 1989), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 84, 439, at 80, 397 (reproposing revised defenition after receiving public comment).

3. *Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Exchange Act Release No. 28869 (Feb. 8, 1991), at 87-88.

form may be disregarded where, as here, it produces an inequitable result, such as the defeat of a statute or public policy.

For the purposes of 16(b) in this case, the formal corporate distinction between Viacom and International should be disregarded and, instead, Viacom should be considered to be the owner of International's 16(b) claim against petitioners, thereby conferring upon any security holder of Viacom, such as Respondent, standing to sue under 16(b).

In *Flink v. Paladini*, 279 U.S. 59 (1929), a tugboat engineer injured on the high seas sued not only the corporate owner of the boat, a California corporation, but also its stockholders, under the provisions of the California Constitution and Civil Code that imposed pro rata liability on shareholders of California corporations for the debts of the corporation. The shareholders defended by claiming that the federal maritime statute limited the liability of the "owner" of a vessel for such injuries to the value of its interest in the vessel and pending freight. The Court construed the statutory term "owner" to include shareholders of the corporate owner, stating per Holmes, J. (*Id.*, at 62-63):

> "The Circuit Court of Appeals disposed of the case after a thorough discussion. It is unnecessary to do more than to make a short statement of the points. The purpose of the act of Congress was 'to encourage investment by exempting the investor from loss in excess of the fund he is willing to risk in the enterprise.' (citations) For this purpose no rational distinction can be taken between several persons owning shares in a vessel directly and making the same division by putting the title in a corporation and distributing the corporate stock. The policy of the statutes must extend equally to both. In common speech the stockholders would be

called owners, recognizing that their pecuniary interest did not differ substantially from those who held shares in the ship. We are of opinion that the words of the acts must be taken in a broad and popular sense in order not to defeat the manifest intent. This is not to ignore the distinction between a corporation and its members, a distinction that cannot be overlooked even in extreme cases (case citation), but to interpret an untechnical word in the liberal way in which we believe it to have been used—as has been done in other cases. (citations)"

In *Anderson v. Abbott*, 321 U.S. 349, *reh'g denied*, 321 U.S. 804 (1944), which involved federal statutes imposing double liability on "shareholders" of national bank, the Court disregarded corporateness and imposed the statutory double liability on individual shareholders of bank holding company that owned the national banks. After finding that the bank holding company was organized in good faith and was not a sham (*Id.*, at 356), the Court stated (*Id.*, at 361-363):

"Normally the corporation is an insulator from liability on claims of creditors. The fact that incorporation was desired in order to obtain limited liability does not defeat that purpose. (citations) Limited liability is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted. But there are occasions when the limited liability sought to be obtained through the corporation will be qualified or denied. Mr. Chief Judge Cardozo stated that a surrender of that principle of limited liability would be made 'when the sacrifice is so essential to the end that some accepted public policy may be defended or upheld.' *Berkey v.*

Third Ave. Ry. Co., 244 N.Y. 84, 95, 155 N.E. 58, 61, 50 A.L.R. 599 (additional citations). The cases of fraud make up part of that exception. (citations) But they do not exhaust it. An obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability. (citations) That rule has been involved even in absence of a legislative policy which undercapitalization would defeat. It becomes more important in a situation such as the present one where the statutory policy of double liability will be defeated if impecunious bank-stock holding companies are allowed to be interposed as non-conductors of liability. It has often been held that the interposition of a corporation will not be allowed to defeat a legislative policy, whether that was the aim or only the result of the arrangement. (citations)...

* * *

"To allow this holding company device to succeed would be to put the policy of double liability at the mercy of corporation finance. The fact that Congress did not outlaw holding companies from the national bank field nor undertake to regulate them during the period of Banco's [bank holding company's] existence can hardly imply that Congress sanctioned their use to defeat the policy of double liability."

The corporate distinction between International and Viacom (formed as a shell corporation to hold International as its only asset) is gossamer. For the remedial purposes of 16(b) in this case, such flimsy distinction should be disregarded.

POINT II

RESPONDENT'S DOUBLE DERIVATIVE ACTION WHEREIN VIACOM SUES DERIVATIVELY UNDER 16(b) ON BEHALF OF INTERNATIONAL (THE INITIAL ISSUER) TO RECOVER PETITIONERS' SHORT-SWING PROFITS OBVIATES PETITIONERS' OBJECTIONS TO STANDING.

The amended complaint alleges, in the second cause of action, a double derivative action wherein Viacom sues derivatively under 16(b) on behalf of International (44a). The amended complaint alleges demand upon the Board of Directors of both Viacom and International (43a, ¶ 21) and, further, alleges that Respondent owned the stock of International prior to the restructuring and at all times material to his action (40a, ¶ 9).

In its opinion below, the Second Circuit stated: "Because the plaintiff [Respondent] has standing under 16(b), we do not reach the district court's rejection of plaintiff's standing argument based upon an alleged 'double derivative' action..." (18a). Upon this appeal, Respondent, as the respondent herein, urges upon the Court the validity of his double derivative action.

It is established law that a double derivative action may be brought pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. Thus, 3B Moore's, *Federal Practice*, ¶ 23.1.17, pp. 23.1-69 to 70 (1987 ed.), states:

> "An individual stockholder of a corporation which is a holding company holding stock of operating corporations may maintain a derivative action for the benefit of the operating corporations, joining them as parties, on the theory that the holding company could sue derivatively on behalf of the subsidiaries and that on failure of the holding company to act, plaintiff, its stockholder, may sue. There is nothing in Rule 23.1 to justify a contrary conclusion. Such a suit is known as a 'double derivative' action."

See, similarly, 7A Wright, Miller & Cooper, *Federal Practice & Procedure*, § 1821, pp. 4-6 ("Also covered by this rule [Rule 23.1] is the so called 'double derivative action' in which a stockholder of a parent corporation brings suit to redress a wrong allegedly done to a subsidiary corporation owned by the parent."); Note, "*Suits By A Shareholder In A Parent Corporation To Redress Injuries To The Subsidiary*," 64 Harv. L. Rev. 1313, 1314 (1951) ("Judicial acceptance of the double derivative suit has been almost without exception;")

Thus, the Second Circuit in *United States Lines v. United States Lines Co.*, 96 F.2d 148, 151 (2d Cir. 1938), directly held that a double derivative action is maintainable, as it did also in *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir. 1944), *cert. denied*, 323 U.S. 737 (1944).

In Respondent's double derivative action, Viacom is suing derivatively under 16(b) on behalf of International. "When a shareholder in the parent corporation seeks to enforce derivatively the parent corporation's derivative right to sue on behalf of the subsidiary, the suit which the shareholder brings has been labeled 'double derivative'" and the shareholder is enforcing a right 'twice derived.'" Note, 64 Harv. L. Rev., *supra*, at 1313.

In this case, Respondent is enforcing derivatively Viacom's derivative right to sue on behalf of International under 16(b). Respondent is thus enforcing, through the accepted and established procedure of the double derivative action, the right of Viacom as a shareholder of International to sue on behalf of

International under 16(b). The end result is that Viacom in effect is suing on behalf of International (the issuer) under 16(b).

No special reason exists for deciding against the maintainability of a double derivative action in the context of 16(b). On the contrary, the double-derivative action in this case subserves, rather than subverts, 16(b). On the contrary, also, as discussed, a long and unbroken line of decisions liberalizes procedural requirements in 16(b) cases.

Professor Loss states (V Loss, *Securities Regulation*, p. 3012 (1969 Supp.)):

> "When a 10 percent stockholder is itself a corporation and it does not bring an action, there is no reason why a stockholder of that corporation could not bring a derivative action, in the proper sense of the term, which, in so far as the 16(b) action is itself in the nature of a derivative action, would be really a double derivative action. This was done without comment by the court in *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968)."

In Blumberg, *supra*, p. 364, it is further stated:

> "There seems no sound reason why the alternative derivative remedy, relying on both Rule 23.1 and section 16(b), should not be available to a shareholder of the parent of the issuer. The adverse decision on the primary cause of action in *Portnoy* rested on a close reading of the provisions of section 16(b), which the court concluded did not give a primary cause to persons who were not literally shareholders of the issuer. But nothing in the decision suggests that a derivative cause of action to enforce a primary cause of action literally within the Act should not be available. Similarly, there is no basis for suggesting that the

> remedy to security 'owners' granted by section 16(b) was intended to be exclusive or to bar derivative actions that would otherwise be available.", citing Annot. 51 A.L.R. Fed. 793 (1981) ("it would appear that the stockholder of the parent should be able to maintain a derivative action to enforce the right of the parent [under 16(b)].")

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the court below sustaining Respondent's standing under 16(b) should be affirmed; or that, alternatively, the Court should sustain the maintainability of Respondent's double derivative action under 16(b).

Respectfully submitted,

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